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THE
COST OF TAXATION

AN ADDRESS,

BY

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THE COST OF TAXATION

Charles E. Stone, on the "Cost of Taxation," read before the Institute of Chartered Accountants in St. George's Hall, on Thursday evening. In fact the paper made such an impression on the Chartered Accountants that it was decided to meet again in two weeks for more thorough discussion. The paper reads:

It is in the belief that it is not the tax alone, nor chiefly, but its effect upon the lives, industries and morals of a people which is of paramount importance, that I have chosen for the subject of my paper the title of the "Cost of Taxation;" the word "cost" in this instance being intended to convey a meaning deeper than the purely fiscal consideration of the question, to which, however, the chief portion of this paper must necessarily be devoted, leaving largely to inferences which may be drawn from its title and references, that which properly belongs to the domain of ethics.

THE PURPOSE.

It will be my purpose to endeavor to conduct a short enquiry into the working and effects of the methods of taxation commonly in use in this country, and the testimony of experience as to their results.

The constant interference with business which many forms of taxation involve would alone afford justification for directing the attention of accountants to the subject, apart from the fact, I believe, that in past years questions contained in the examination papers of this Institute have implied that the applicants for its charter have been expected to have given some attention to the study of economics, of which taxation is an important branch.

APPEAL TO ACCOUNTANTS.

In so far as the question is a fiscal one, there is no class of men to whom, from its very nature, it can appeal with more force than to gentlemen following the profession of accountancy, nor can I think that the public would give greater weight to the opinions of any body of men on the subject than to the deliberate expressions of the members of the Institute of Chartered Accountants, to whose individual guidance are entrusted with every confidence some of the most important branches of their financial and industrial operations.

APPEAL TO OTHERS.

The question of taxation is one of such scope and magnitude that the difficulty in preparing a short paper of this kind consists not so much in what to say as in what can be eliminated from that which one feels it necessary to say, and still have each point touched upon, if ever so

lightly, and touched upon in such a manner that any thinking person, even though he hold a diverse opinion, shall at least concede for each argument a foundation in reason; and when we come to consider that every man who works is a taxpayer, we must perceive that this includes a large class of men, who, believing themselves free, are perfectly careless of the whole matter. How many young men, for instance, who fill the numerous boarding-houses of every large city, and have successfully avoided the small income or statute labor tax, know themselves to be taxpayers at all? And of those who know this, how many have been brought to see, that in proportion to their earnings and the benefits they receive from government, they are among the heaviest taxpayers and are, moreover, as a class, among the chief sufferers from any maladjustment of the social system which can be traced to the effects of unwise and inequitable taxation, when by its instrumentality the concentration of wealth is facilitated, burdens are imposed and opportunities withheld.

ORIGIN OF TAXATION.

I hardly consider it necessary, nor is it easily possible in the limited space of a paper of this kind, to dwell upon the origin of taxation, because such an enquiry, carried to its logical conclusion, would lead us to an investigation into the origin of government. It is sufficient for our purpose to know that we have government and to concede that we are not aware of any means of dispensing with it, and wherever government exists, it, in the nature of things, implies the necessity of a revenue to provide for the benefits of communal existence.

WHAT IS TAXATION?

Taxation is the indispensable condition of government, it is the term by which we designate that portion of the product of our industry which we devote to a common fund, ostensibly to provide for such needs as we find we have in common, and which multiply as civilization grows more complex, advantages to be derived from it apparently enhancing with its growth; and it would certainly seem that if equity governed the collection and expenditure of this fund, it must yield benefit to every member of a community equivalent to his payment.

It is with mistaken solicitude that we devote almost all our attention to the manner in which our taxes are expended, neglecting almost entirely to appreciate that in an inequitable system of collection lurks an evil infinitely more far reaching in its effects upon the individual and upon the community.

STUDY OF THE PRINCIPLES.

The first step, however, towards a correct system of taxation is the study of the principles on which it depends.

Adam Smith was one of the first to attempt to formulate the truths upon which a tax system should be based. His canons of taxation were in substance, convenience, economy, certainty and equality, and these I believe have been generally concurred in by Fawcett and subsequent writers, while their practical application has been no less generally neglected.

Taxes, therefore, would seem to be good or bad, in so far as they operate for or against the following principles:

(1) Good when they bear as lightly as possible upon production, so as to offer the least discouragement to the growth of the general fund from which they must be paid and the community supported.

Bad when they unnecessarily hinder the increase of wealth and comfort among the people as a whole.

(2) Good when they can be easily and cheaply assessed and collected.

Bad when they operate to cause the real taxpayer to pay in excess of what they actually yield the government.

(3) Good when they are certain and afford least opportunity for evasion on the part of those intended to bear the sacrifice.

Bad when they can be easily avoided by fraud or falsehood, and tend to increase proportionately the burden of the honest and truthful, or by adding to prices shift the burden on others.

(4) Good when they bear equally and put no citizen at a disadvantage as compared with his fellows.

Bad when their tendency is to take from the poverty of the poor and to add to the wealth of the rich, or when they oppress most heavily upon those who derive least benefit from the government; and also they are bad as they tempt one class to seek an increase of taxes to be imposed upon another class.

Government taxation assumes two main forms: 1, direct, and 2, indirect.

It exists by two necessary acts: 1, the assessment of values, and 2, the collection of wealth.

Is mainly guided by two principles: 1, taxation according to benefits; 2, taxation according to ability to pay, and is levied ostensibly for two purposes: 1, to provide a revenue for the requirements of government; 2, to protect wage-earners.

We are considering the proper method of raising necessary revenue; of the various forms in operation that will be deemed best, which most accords with what has been laid down as good in the principles just enunciated.

GENERAL INCOME TAX.

The first impression of most people probably favors a general income tax; a tax from incomes from earnings as well as from investments, and it may be cited in favor of this that it is in the nature of a direct tax. And that if levied exclusively at the sources of income it may with reasonable certainty be made to reach all

rents, dividends, corporate payments of interests, and perhaps interest upon mortgages; some incomes from invested wealth can then be reached, but not all of them.

John Stuart Mill says of the income tax, "that the fairness which belongs to it in principle cannot be made to attach to it in practice, and that it has such objections in practice that it should be reserved only for special emergencies."

Germany has long levied an income tax, and Prof. Goldwin Smith is quoted as saying that "there is no complaint in regard to it," and the same authority says: "In France the attempt to introduce it utterly failed." And just here it may be noted that Germany has an enormous and almost perfect military organization, which in the absence of foreign wars is an excellent factor in suppressing complaints.

In England the income tax is the largest of the internal taxes, and yields a large revenue, yet the organized opposition to it is strong and active, and at the very time of its introduction it was stigmatized by Sir Robert Peel as obnoxious and inquisitorial, and a tax which should be reserved for war.

TWO OBJECTIONS.

The income tax is open to at least two objections:

First, that it is extremely difficult to collect fairly, and the manner in which it is regarded and where possible evaded is best evidence of this, and is exemplified in various citations which have appeared in our own daily papers. That such a system as this works an injustice, puts a premium upon deception, and prompts an otherwise honorable man to stultify himself by avoiding his just share, must be apparent.

That the system operates to work this injustice is also apparent from the fact that while the assessment of the financial and professional classes is largely dependent upon their honor, or lack of honor, that of the clerk or mechanic can usually be obtained by application to his employer.

Secondly: Even where the income tax is a graduated tax it has not that fairness which would appear on its face.

It would not be possible where the method of collection was by levying on incomes at their source, and as a consequence the number of instances would be greatly increased in which the assessor would have to rely upon the word of the taxpayer, and incentive to evasion would therefore also increase.

The income tax also usually carries with it an exemption up to a certain amount and it then comes under the head of taxation according to superior ability to pay, and operates as a fine upon industry, thrift and frugality; it is taxing the actually and nominally rich for the benefit of the actually and nominally poor, and has no firmer foundation in equity than has a tax which operates in favor of the rich and to the detriment of the poor.

Thirdly: I think it can be shown that the income tax if paid at all is paid out of the savings, and herein tends to undo the very work we are ostensibly trying to do through the institution and encouragement of our savings bank system.

A TAX UPON INDUSTRY.

At the commencement of this inquiry into the income tax I cited it as being in the nature of a direct tax (one that did not admit of being shifted), and in so far, commendable. Many economists are reputed to be in accord as to the general truth of this, yet it is not always true. Look at it in the best possible light we can, make all the excuses for it we can, it is still a tax upon industry, a fine in other words on superior ability, and as such reduces wealth by limiting enterprise, education and training, and is therefore in its ultimate effects the same as increase of price, since it reduces purchasing power. The retrenchment of expenses which the income tax would make desirable to all and necessary to many would act in this way.

PERSONAL PROPERTY TAX.

Let us now consider the personal property tax, dividing personal property into two classes—chattels and credits. Chattels include food, clothing, furniture and all things necessary to satisfy human desires. Credits include bonds, mortgages, notes, bank deposits, book accounts, shares of corporate stock, etc.

The personal property tax is probably that most frequently brought to the attention of accountants among the items of expense in the books of their clients. The personal property tax is to the mercantile class what the income tax is to other classes previously referred to, but with this difference, that it is an indirect tax, which is almost invariably shifted on to other shoulders, and this I intended to imply when I previously referred to its inclusion among expense accounts.

It has every objection which can be brought against the income tax, and none of its presumable virtues.

It also is inequitable and places a premium upon misrepresentation and evasion, tending to stultify the character of every merchant or manufacturer who, struggling between his principles of right and wrong, and his knowledge of the fact that many of his estimable friends pay only such taxes as they cannot avoid; finds profit in deception.

A UNIQUE CONDITION

It also comes directly in the nature of a levy upon what we are taught to believe to be the virtue of frugality, discouraging a man just in proportion as he is careful and saving and literally fining him for not consuming his wealth as fast as he acquires it. While at the first blush it appears to operate in favor of the profession and the clerk as against the merchant by taxing the former upon his income and the latter upon the whole or chief source of his income and each at the same rate, such is not the case, the merchant actually transferring it to his customers, since it is one of the factors which must determine the price at which he can afford to sell his goods.

EXPLANATORY ARGUMENT.

At the risk of appearing lengthy I would like to enlarge upon this. Capital expects some return wherever invested, the lowest price generally accepted for its use is where the risk of its loss or depreciation is

least, which in this instance I will cite as British consols, and the lowest return at say, 2 per cent.; from these up to mortgages and similar securities at 6 per cent. or 7 per cent., there are a host of investments, yielding various returns according to their desirability, flexibility and the element of risk accompanying them; therefore to atone for the risk of its venture in mercantile pursuits, it follows the return there must be greatest. This is true whether the returns from other investments be from 2 per cent. to 7 per cent., or more or less; there can be no arbitrary sum, because when the returns from investment in mercantile pursuits refuse to yield to capital sufficiently more than the investments which do not partake of the same element of risk, capital withdraws only to compete with itself in the safer field until the returns therein are forced down to such a level as drives it back to business risk (a process hastened by the scarcity due to its temporary absence), for a lower return than it previously received in the same field, but still in the same ratio to the safer investments which it previously bore.

While capital therefore has the potentiality to earn specific returns for its use, according to the risk, any tax upon it acts as an expense of maintaining it in its sphere, and must be refunded in the form of enhanced profits.

ANOTHER INEQUALITY.

There is an apparent exception to this which, however, is really destroyed by the element of injustice under which it would operate, for while taxes upon merchandise and machinery equally distributed simply increase the cost of goods to consumers, it is manifest that where they are unequally distributed it is impossible for the merchant or manufacturer who is taxed beyond his just share to recover such tax from his customers, while his competitor who is taxed below his share can recover from his customers all he would have paid under strictly equal taxation, and actually profits by the inequality of the system.

Again, let us try to trace its effects upon the primitive industries of which farming will serve as an illustration. The personal property tax imposes itself first upon the farmer and adds to the price he must obtain from the factory for his products. This tax reimposes itself in the factory where the farm product is converted into usable form, and again when the finished article forms part of a merchant's stock, which article finally reaches the consumer with this tax three times imposed, together with the usual rate of profit thereon. The increase in price resulting therefrom lessens the quantity of farm products the consumer can afford to acquire lessens the sales of the merchant and his orders from the factory, finally reaching the farmer by curtailing the demand for his products, forcing him to content himself with less of the products of other industries and taking one step in the direction of hard times.

IT REDUCES CONSUMPTION.

The personal property tax, in so far as it acts upon production, reduces consump-

tion, and along with every other tax that operates in the same way is responsible for its share in the cause of industrial depressions.

Another thing—if there is any efficacy in the taxation of foreign products for the encouragement of home industry, every cent of internal taxation that can be added to the cost of the article of home production before it reaches the consumer must operate to nullify any ostensible benefit there is in any import duty.

AS TO CREDITS.

Now, as to credits. It is a doctrine dear to the farmer's heart, as justifying all his favorite theories of taxation, that the wealth of a community is actually increased by credits. This is not true; debt cannot increase the general stock of wealth, although the system of extending credit may operate in this direction to increase wealth—credit being primarily the instrument by which capital is transferred, for a time, from the hands of men who cannot use it most productively into the hands of men who can. Every credit implies a debit, one gives exactly what the other gets, and to this extent the property in the hands of a debtor really belongs to a creditor.

The records of experience teem with illustrations of the utter impossibility of equitably taxing wealth as represented by credits—the experience in many communities being that the assessors cannot find 5 per cent. of such wealth, while in every case where an attempt is made to assess it there is exhibited a remarkable power of secreting itself, and it is almost amusing to read accounts of how such wealth diminishes or disappears entirely under the influence of a tax.

TARIFF TAXES.

While all that I have said of the personal property tax would argue for its abolition, this is not recommended solely because of the facility and persistency with which it is evaded, but upon the broader grounds that every exemption of personal property would free business to that extent, thereby stimulating and encouraging the production and distribution of wealth, which would result in more regular employment to the masses at remunerative wages. In dealing with the subject of taxation it is hardly possible to omit any reference to the question of the several customs duties, although I have felt constrained to do so from the fact that I am trying to deal with general principles and would prefer to avoid anything which might have a tendency to bring the discussion within the domain of party politics.

The reasons for maintaining the tariff may be gathered from the objections generally urged against its abolition. The first is that their removal would seriously impair, if not ruin, many of our home industries, which are presumed to require their protective feature, and the second, that there is no other popular way of raising the revenue which is yielded by the tariff.

The first is far too complicated and delicate a question of trade policy to admit of its discussion here, many of its adherents holding that the tariff is not a tax

at all, but merely a means of fostering industry, and believe that it should be gradually dispensed with when no longer needed.

INDIRECT TAXATION.

The second, however, in so far as it implies taxation for revenue purposes, is distinctly within the scope of our enquiry. In the first place it is an indirect tax almost invariably shifted by the first payer from himself to others.

William Pitt, in a speech in the British Parliament, is reported as having said:

"To levy a direct tax of 7 per cent. is a dangerous experiment in a free country, and may excite revolt, but there is a method by which you can tax the last rag from the back, and the last bite from the mouth, without causing a murmur against high taxes; and that is to tax a great many articles of daily use and necessity, so indirectly that the people will pay them and not know it. Their grumbling will then be of hard times, but they will not know that the hard times are caused by taxation."

The very irony of this plea for indirect taxation tends to emphasize the importance of taxation as a labor question. When taxes are laid indirectly upon consumption, whoever works for a living, whether he own property or not, is a taxpayer, and the stealthy manner in which such taxes are drawn from the laboring classes is largely responsible for the supposition that those classes contribute nothing to the support of government and for the proposition sometimes evoked that they should accordingly be disfranchised.

TAXES UPON IMPORTS.

Taxes upon imports by whomsoever paid to the Government are finally collected through the retailer from the consumers who buy the goods, and upon these consumers, though they may not be accounted taxpayers, the whole burden finally falls. Not only this, however. The profits of dealers upon the indirect taxes which they pay in the first instance are plainly a charge upon consumers.

THE FINAL PURCHASER PAYS.

As each import tax enters into the cost of an article as it awaits the final purchaser in a retailing establishment, the laws of competition permit the merchant to exact from his customers not only the tax, but also the ordinary rate of profit in his line of business upon that tax. Consequently the cost of imported commodities to the consumers consists not alone in the cost and profits involved in acquiring and delivering the goods, nor even of that amount plus the taxes, but of that amount plus the taxes, plus the profits upon those taxes.

The enormous expense attendant upon the collection of import duties, all of which must be borne by the industries, and the reduction in the ranks of producers consequent upon the army of men engaged in operating the system, is in itself a tax by no means insignificant enough to disregard.

The inquisitorial nature of the system, conducing to servility on the part of importers and arrogance of the customs officers, the opportunity it affords for petty

tyranny or corruption on the part of the officials, the injustice to the poorer classes of the tax according to weight and measure, the intermingling of politics with business and the constant interference with production and consumption, all these are so generally conceded as objections to the import tax, considered solely as a means of raising revenue, that they need no further mention here.

INLAND REVENUE TAXES.

The inland revenue taxes, considered merely as a form of taxation, are similar in their operation and in their effects, and in thus classing them I wish to be clearly understood as offering here no criticism upon them in so far as their purpose is to supervise and restrict the manufacture, sale and consumption of tobacco and intoxicants, but in so far as they are successful in this they only serve to substantiate the claim that a tax upon the necessities of life operates to reduce the quantity of them which a poor man can afford to procure.

Let me interpose the supposition that a change were effected in the method of collecting the Government tax on imports. If instead of being intercepted at the custom house all the articles imported by our large retailing establishments were delivered to their free of duty, and Government officers were stationed at their doors to collect from the final purchasers as they were leaving the amounts they now pay as part of the price of the goods, how long would it take the people to stop their grumbling about hard times and devote some significant attention to these taxes which now they hardly know they are paying?

TAXES ON IMPROVEMENTS.

We proceed to consider the taxation of improvements upon land—chiefly buildings—a tax which seldom is considered upon its merits because it is erroneously identified with the tax upon the value of land, and classified as real estate.

The taxation of improvements upon land is in many ways attended with injury to the public good. In the first place this again is an indirect tax, shifted in the cases of houses, from the owners to the users, lessening their ability to acquire the products of industry, and bearing with more severity upon the poor than upon the rich; shifted also in the case of buildings occupied for business purposes, just as are the personal property and tariff taxes in the increased cost of goods to consumers.

Most commodities being produced and retailed under circumstances of keen competition are sold close, consequently the taxation of the factory or store expresses itself in the price of goods more decidedly than it may appear to upon a mere cursory examination of the question.

That beautiful buildings are a source of constant instruction and delight is evidenced by the pride with which they are pointed out to visitors in any large city, and the uninitiated would naturally suppose their erection was encouraged in every possible manner; but the very reverse is the case. We fine the man who puts up any kind of a cheap, unpretentious building, and we fine him heavier when he erects a beautiful structure, and continue to fine him every year until it is pulled down or destroyed by fire.

AN UNJUST SYSTEM.

We fine the man who builds a verandah to his house, who paints and beautifies an old dwelling and replaces old windows with new plate glass, or makes any other improvements thereto; and worse than that, the instances are not few when the expenditure of one or two hundred dollars in making the front of a house neat and agreeable has been followed by an increase of a thousand dollars or more in the assessment, this bringing the tax up to 12 or 15 per cent. of the actual cost of the improvements, and this seeming incongruity and injustice is inherent in the system. Thus the taxation of buildings and improvements upon land is a constant and severe discouragement to the erection of buildings, and particularly to the development of taste and beauty in architecture, and militates against the constant employment of all whose business it is, or might be, to design, construct or repair, and to that extent its operation tends to curtail the demand for the articles which they should consume, and is consequently reflected in every line of business which is unnaturally depressed to that extent.

ONE EVIL.

Quite recently the editorial columns of Saturday Night drew attention to the evil effects of the old, decayed and unhealthy dwellings in certain parts of the city. The tax upon improvements is not without its responsibility for this, because it would fine the owners of these rookeries for making any substantial and visible improvements, and fine them heavier still for destroying them and erecting clean, comfortable homes upon their sites. The users in these cases not being of the class from which these fines can be so readily collected, there is every inducement for the owners to maintain them as long as possible in their present squalid and unhealthy condition, and if we argue that a better class of people would be attracted to these new or improved dwellings, able and willing to pay to the owners a return commensurate upon their investment, compared with what they now receive, we are still left with the problem, under existing conditions, of how to provide for the class which now occupies them.

ALL HAVE EVILS.

We have now considered almost every important form of taxation, we have tried them all according to the canons of taxation, setting forth the principles concurred in by some of the most eminent economic writers, and we have found them all wanting.

Some of them appear to have violated every principle of equity and justice, all of them have violated some of these principles. We have found them all to be taxes upon industry operating to cause under consumption, the real name for business depression, generally attributed to, and agreed to exist through, what I believe is mis-called "over production."

We are left to consider but one important subject for taxation, and if we fall therein to find a species of taxation which automatically collects from every citizen an amount almost exactly proportioned to the benefits he derives from government, we

must infer that taxation is merely a guess and a scramble, incapable of being conformed to the principles of justice and equity. But is this really so?

THE TENDENCY.

The tendency of enlightened law-making is to fix taxes mainly on real estate, the land value as distinguished from the improvements, and whatever view we may take of the real or assumed defects of such a tax, it argues a tendency to simplify the theory and application of taxation and to reduce to a definite and general principle the confusion of present methods. In the first place, the tax upon ground rent or site value is a direct tax, resting upon the owner of the site, instead of shifting to the tenant in higher rents. This is made a fundamental doctrine of the science of economics by Ricardo, Mill and other economic writers of repute and might be easily tested here but for the necessity of limiting this paper.

This tax is also specially adapted to municipal wants, as the assessable value of land is constantly progressive and increasing in a direct ratio to the growth of population, and the very causes that increase and multiply the demands made on it increase proportionately its ability to meet them. All over the world men pay to a superior authority a tribute proportioned with wonderful exactness to the advantage derived from social organization.

Each man is compelled to do this by the fact that other men surround him, eager to pay tribute in his place if he will not. And thus we find in actual operation a species of taxation which does automatically collect from every citizen an amount equivalent to the full market value of the benefits which he derives from Government and the society which surrounds him, but the power to collect this tax has been delegated to individuals, and in their hands it is called "rent." It is well to remind ourselves that we already collect a tax upon land values, and in the case of Toronto upon an assessment approaching a hundred million dollars, thus relieving industry to that extent, since it would have to bear an additional burden if this tax were eliminated.

CONCLUSIONS.

Whether the further relief to be afforded by the greater concentration of taxation upon land values would be such as to justify such a measure, should follow from its examination according to the canons previously enunciated—Convenience, Economy, Certainty, Equality.

Its convenience is exemplified in the fact that it does not increase the cost of production, nor interfere with the process of distribution, since it would divert to Government uses a portion of a fund which now goes to the individuals in the form of rent, the volume of which is regulated by the law of supply and demand, and is not

susceptible to arbitrary increase, as may be seen from the fact that rent now exacts to the full extent of its ability.

Its economy consists partly in the fact that its subject is the most easily seen and valued for assessment of all classes of taxable property, requiring the withdrawal of the fewest men from the number engaged in production, and partly in the fact that, being a direct tax, there is little room for it to cost the taxpayer much in excess of what is received by Government, as we have seen is the case with the personal property and other taxes.

Its certainty is largely apparent from the fact that land stays always in one place and cannot be hidden from the observation of the assessor, nor can its value easily be sworn away by those who would resort to deception for the purpose of evasion, competition for its use being always efficient for determining its value for assessment.

Its equality and fairness is dependant upon its ability to return to the taxpayer an equivalent benefit, and this it does in so far as the tendency of every economy resulting from improvement in government, of every advantage accruing from public improvements, of every reduction in the cost of public services and of every addition to their extent and efficiency is to enhance the value of land quite independent of the individual exertion of the owner, and to increase the amount he is able to exact in the form of rent, and when the cost of public services is borne by the industrious they pay twice for them, once to the Government for their cost, and again to the owner of the land for their advantages.

The special privileges constituting the value of public franchises, which often escape their fair share of taxation, would be reached by enhancing the taxation of land values, since these privileges consist largely of the exclusive ownership or use of land, for the operation of railway, telephone, telegraph, gas or electric services.

I am conscious of having omitted to deal with several minor forms of taxation, such as the succession tax and others, and of having given this whole important subject but a superficial and inadequate treatment.

THE COST THE QUESTION.

But as I must now draw to a conclusion, permit me for a moment to recall the title of my paper and to point, this time with emphasis, to the full and complete meaning of the word "Cost" in this connection, confirmed as I am in the belief that an investigation and inquiry into the relation which taxation bears to the whole social question will reveal the real fountain whence emanates the chief cause of industrial depressions, and taking this view of the subject it assumes a position of paramount importance to all who believe in the possibility of a condition of harmony in the industrial world, when with equity for a foundation, the law of equal freedom shall be the law of social life.

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